

**WRITTEN STATEMENT
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**BEFORE THE
HOUSE OVERSIGHT & INVESTIGATIONS SUBCOMMITTEE
OF THE HOUSE FINANCIAL SERVICES COMMITTEE**

MAY 23, 2002

Madam Chairman and Members of the Subcommittee:

I am Marc E. Lackritz, President of the Securities Industry Association (SIA).¹ Thank you for the opportunity to testify today to describe the regulatory structure of the securities industry, the efforts we're making to continually improve compliance and prevent fraud, and the new investor education and information efforts underway to help empower investors.

The securities industry is profoundly concerned whenever an investor loses money through fraud, and we share your Subcommittee's outrage over this particular incident. Indeed, we are embarrassed that this type of fraud has occurred because, although it happens only rarely, it simply should not occur at all. Our industry prides itself on our dedication to ensuring the highest ethical standards among our professionals and our deep commitment to earning the public's trust and confidence that the markets operate fairly with complete integrity. When that trust and confidence is undermined in any way, our reputations are diminished and investors become more reluctant to provide the capital that companies need to grow and flourish, employ

¹ SIA represents the shared interests of nearly 700 securities firms. SIA member-firms (including investment banks, broker-dealers and mutual fund companies) are active in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In the year 2001, the industry generated \$198 billion in U.S. revenue and \$358 billion in global revenues. Securities firms employ over 750,000 individuals in the U.S.

more workers, and provide financial returns that boost our nation's prosperity. While these problems are extremely rare, when they do happen, they unfortunately tarnish the reputation of the industry and the hundreds of thousands of professionals who have worked so hard to ensure that their clients are well served. That is why we have no tolerance for those who have broken the law, and we believe bad actors should be prosecuted to the full extent of the law.

The Securities Industry's Multi-Tiered Regulatory Structure

Although this, or any, episode of fraud is egregious and unacceptable, it is important to note how rare, and even unique, incidents such as these are. In relation to the number of transactions, the percentage of complaints against brokers is very, very small. Customer complaints to the SEC in the first quarter 2001 show that only one out of 172,000 transactions even gives rise to a complaint. That means that more than 99.99 percent of all transactions result in no complaints, a record other industries and professions envy.

Since 1995, the increases in dollar volume and securities transactions (269 percent and 510 percent, respectively, between 1995 and first quarter 2001) dwarf the increase in complaints (44.3 percent). Indeed, every day, nearly \$700 billion in transactions clear and settle on the stock and debt markets based on a handshake, a nod, a hand signal, a keystroke, or a phone call. This would not be possible without a strong and fair regulatory scheme that protects investors and ensures the integrity of the markets.

The first layer of investor protection occurs at the brokerage firm itself, which is responsible for complying with every law and regulation pertaining to its business, including the strict supervision of all personnel. Securities firms must also establish clear-cut financial controls that serve the best interest of their customers. All firms must have ongoing education programs to keep employees up-to-date on industry-, product-, and service-related subjects as part of a mandatory continuing education program. In addition, broker-dealers continue to promote even higher standards of professionalism by voluntarily adopting certain "best practices" developed by SIA.

Self-regulatory organizations (SROs) are the second level of regulation. SROs include the New York, American, and regional stock exchanges, NASD Regulation, and the Municipal Securities Rulemaking Board. SROs verify that brokerage firms have systems and procedures to manage themselves properly and to comply with securities regulations. Some of their activities include regularly reviewing the firms' books and records, administering tests, and supervising the industry's mandatory continuing education requirements. SROs create a compliance system by which individuals and securities firms can police their own activities. For example, NASD Regulation maintains a public disclosure program on its website (www.nasdr.com), as well as a toll-free telephone number (800-289-9999), that provides disciplinary information on all licensed securities brokers. This resource, which we believe is unique in any profession, enables investors to know instantly whether a broker with whom they are considering doing business has ever had disciplinary action taken against him or her. In addition, the SROs discipline their members for violations of securities laws and regulations. In most cases, SROs take the first steps in detecting infractions, and often handle the initial stages in the major civil and criminal proceedings against industry personnel.

The Securities and Exchange Commission (SEC) – the third layer of regulation – is charged with preserving the integrity, efficiency, and fairness of the securities markets by administering and enforcing federal securities laws. It also oversees the SROs. As we all know, the SEC has a long history of detecting fraud and punishing wrongdoers. In fact, this year, it brought more enforcement actions in the first quarter – 61 cases – than it did in the same period last year. In taking the helm of the SEC, Chairman Harvey Pitt is refocusing the agency's role on catching problems early rather than spending years developing a case and then imposing penalties. The new approach has an even greater “chilling effect” on any individual who may be contemplating a new Ponzi scheme. We support this effort and Chairman Pitt's request for more resources to expand the commission's legal and enforcement staffs, and we appreciate this committee's support of greater resources for the SEC. A fully funded SEC is critical for both the securities industry and our customers.

Congress is the ultimate overseer and ensures that the SEC is fulfilling its responsibility to regulate the securities markets. The four layers of federal regulation – as well as state

securities laws that impose additional requirements on broker-dealers and their employees operating within their borders – make the securities industry among the most highly regulated. This regulatory structure has helped to foster the broadest, deepest, most transparent markets in the world, and countries across the globe are emulating our system. We have established a record the entire industry can be proud of, the public can rely on, and other industries can only envy.

Yet once in a while a bad actor slips through this structure and defrauds customers. When this happens, the industry works very hard to make customers whole and to improve our systems for stopping fraud. Broker-dealers have invested heavily in technology that enhances their ability to detect abuses while more effectively managing investors' money. For example, computers compare a client's electronically stored profile against the trades he or she is trying to undertake. If the two don't match, red flags fly. The broker-dealer's compliance officers will scrutinize the activity immediately. New technologies also help securities firms collect, retain, and transmit information to meet their supervisory obligations. In addition, market regulators use sophisticated, state-of-the-art software and computerized surveillance systems to detect and investigate any signs of foul play.

Investor Education More Important Than Ever

In addition to the industry's efforts to stop fraud before it happens, broker-dealers and the industry are redoubling our investor education efforts so that investors will have the necessary tools and skills to invest responsibly and avoid being defrauded. SIA's annual investor survey finds consistently that investors are overwhelmingly content with the service that their broker provides to them.² They value most the time that their broker spends with them, the education he or she provides, and his or her investment recommendations. Even so, a majority of investors still think the industry should do even more to educate the public about investing.

² SIA commissioned Yankelovich Partners in 1995 (acquired by HarrisInteractive in 2001) to conduct an annual survey measuring investors' attitudes toward the securities industry. Percentage of investors "very satisfied" or "somewhat satisfied" with their broker's service: 96% (1995); 94% (1996); 94% (1997); 95% (1998); 95% (1999); 95% (2000); 91% (2001).

As a result, our industry spends a great deal of time and effort to educate investors about the risks and opportunities of investing. Over the last decade, we have published a broad range of brochures to address specific investment issues. When online trading grew quickly, we produced a brochure that outlined the issues that investors should keep in mind when investing online. Amid the bull market, we published two brochures – *Understanding Market Risks* and *Managing Your Expectations For Long-Term Success In The Stock Market* – that cautioned investors about potential risks and explained to them the historical performance of markets. We just released a third edition of our most popular publication – *Your Guide To Understanding Investing* – a plain English, fully illustrated resource for new and experienced investors.

In publishing these materials, we have worked with the SROs and the North American Securities Administrators Association in the hope that together we can reach more investors rather than if we were each to publish individual brochures. Two examples of our collaboration stand out. The first, which we released only a few weeks ago, helps investors interpret their account statements. The brochure also includes a “frequently asked questions” section and an extensive glossary of investment terms that account holders may come across while reviewing their statements. The second warns about promissory notes.

We have also participated in investor town hall meetings across the country organized by the SEC. During these, we often hold a seminar outlining the ten steps of successful investing and explaining investment fundamentals such as how to read a statement and knowing that your brokerage firm must send you a confirmation of any transaction you conduct with that firm. These joint efforts have been very successful, and we look forward to doing even more with the SEC, the SROs, and NASAA. By working together, our impact is far greater than if we were to work alone. And we fully support the Treasury Department’s new campaign for financial literacy – a goal our industry has been committed to achieving for many years through our Stock Market Game™.

Today, more than 600,000 students in the fourth through twelfth grades participate in the 10-week program, which has been run by our Securities Industry Foundation for Economic Education for more than 25 years. The SMG combines basic economic education with an

investment simulation exercise. Students form teams and invest a hypothetical \$100,000 in stocks. While they are choosing which stocks to buy or sell, economic and political events are shaping the markets, causing interest rates and stock prices to change. The program helps students to understand the relationships between economics and markets.

In April this year, we launched a new website, “SIA Investor: Your path to financial knowledge” (www.siainvestor.org). It is an interactive online learning tool that addresses investors’ different needs, from the basics to more complicated questions, such as asset allocation. A unique site, it features five core financial topics: Investing Goals, Investing Essentials, Choosing Investments, Managing Your Portfolio, and How Markets Work. Industry experts offer their views on such topics as portfolio diversification and the 401(k) retirement program. The site is strictly educational, with no product endorsements or advertising, and there are no registration or password requirements. We recently set up computers in the Rayburn House Office Building to allow Members of Congress and their staffs to see how the site works, and the response was very positive.

Conclusion

The securities industry works in concert with government, regulators, and self-regulatory organizations to promote a culture of trust and confidence, which are our most important assets. In such an environment, innovation soars, competition thrives, and investor confidence flourishes. We all have to work together to continue to keep incidents of wrongdoing to a minimum through effective leadership, compliance, self-regulation, and more investor education. These actions will help maintain and enhance the public’s trust and confidence, which is good for investors, good for our industry, and good for our country.

Thank you very much.